

**BELLSOUTH**

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December 19, 1997

Ms. Magalie Roman Salas  
Secretary  
Federal Communications Commission  
Washington, DC 20554

**RECEIVED**

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Re: CC Docket No. 97-208

Dear Ms. Salas:

Attached hereto are portions of the transcript of the AT&T/BST Arbitration in South Carolina relating to the testimony of Joseph Gillan, who testified on behalf of AT&T. This material is being submitted in response to a request by Michael Pryor. Please note Mr. Gillan's testimony on pages 20-22 and 56-57, where he states that competing local networks are years away. He also stated that in the beginning all of the network elements would be purchased from BellSouth.

During this arbitration, AT&T argued in support of a "platform" of unbundled network elements, as it has before the FCC and in other state proceedings. In that proceeding, the South Carolina PSC concluded that network elements that are rebundled to produce an existing tariffed retail service would be treated as resale for pricing purposes. In October, the 8<sup>th</sup> Circuit held that the purchase of assembled platform of network elements at cost-based rates would "obliterate the careful distinctions Congress has drawn" between access to network elements and resale. These holdings demonstrate that AT&T's purported goal of deploying a platform of network elements was premised on a faulty legal conclusion, and should not be accorded any weight.

Very truly yours,



David G. Frolio

cc: Michael Pryor

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**DIRECT TESTIMONY OF DOCKET FILE COPY ORIGINAL**

**JOSEPH GILLAN**

**ON BEHALF OF AT&T COMMUNICATIONS**

**OF THE SOUTHERN STATES, INC.**

**BEFORE THE**

**SOUTH CAROLINA PUBLIC SERVICE COMMISSION**

**Docket No. 96-358**

**Filed: January 6, 1997**

**I. QUALIFICATIONS AND EXECUTIVE SUMMARY OF TESTIMONY**

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

**A. My name is Joseph Gillan. My business address is P. O. Box 541038, Orlando, Florida 32854.**

**Q. WHAT IS YOUR OCCUPATION?**

**A. I am an economist with a consulting practice specializing in telecommunications. My clients span a range of interests and have included state public utility commissions, consumer advocate organizations, local exchange carriers, competitive access providers and long distance companies.**

**Q. PLEASE BRIEFLY OUTLINE YOUR EDUCATIONAL BACKGROUND AND RELATED EXPERIENCE.**

1 A. I am a graduate of the University of Wyoming where I received B.A. (1978) and  
2 M.A. (1979) degrees in economics. My graduate program concentrated on the  
3 economics of public utilities and regulated industries.

4  
5 In 1980 I joined the Illinois Commerce Commission where I had responsibility for  
6 policy analysis relating to the emergence of competition in regulated markets, in  
7 particular the telecommunications industry. While on the staff of the Commission, I  
8 served on the staff subcommittee for the NARUC Communications Committee and  
9 was appointed to the Research Advisory Council overseeing NARUC's research  
10 arm, the National Regulatory Research Institute.

11  
12 In 1985, I left the Commission to join U.S. Switch, a venture firm organized to  
13 develop interexchange access networks in partnership with independent local  
14 telephone companies. At the end of 1986, I resigned my position of Vice President-  
15 Marketing to begin a consulting practice. I currently serve on the Advisory Council  
16 for New Mexico State University's Center for Regulation. A complete listing of my  
17 background, publications and prior testimony is included as Attachment JPG-1.

18  
19 **Q. WHY ARE YOU PROVIDING TESTIMONY IN THIS PROCEEDING?**

20 A. AT&T has requested that I discuss the impact of the principal issues in this  
21 arbitration on competition in general and, perhaps more importantly, the intended  
22 beneficiary of competition, consumers. Competition now resides at the heart of the  
23 nation's telecommunications policy. This is not because it benefits competitors, but  
24 because competition is the best mechanism to provide consumers with the lowest

1 prices and greatest choices -- and because where competition flourishes, regulation  
2 and government intervention are unnecessary.

3  
4 However, the fact that the parties before this Commission are large companies,  
5 should not be confused with the nature of their debate. In one corner, you have  
6 BellSouth, a monopoly whose incentive is to do as little as possible to open its  
7 markets. In the other corner, you have AT&T, a potential new entrant with the  
8 desire to offer local services broadly throughout South Carolina. Certainly, each  
9 party is primarily motivated by its own self-interest, but the public-interest  
10 embodied in the Telecommunications Act of 1996 (the Act) is providing consumers  
11 with choice. In this regard, AT&T's desire to offer services in competition with  
12 BellSouth and the public interest align.

13

14 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

15 **A.** The Act holds the promise of a new era in telecommunications, an industry that  
16 provides the foundation for a modern, information-based, economy. This arbitration  
17 will implement those sections of the Act designed to open local exchange markets to  
18 competition, providing consumers a choice of their local service provider and  
19 promoting the deployment of new technologies, services and networks.

20

21 The issues in this arbitration are complex, but its objectives are clear. In the  
22 testimony which follows, I demonstrate that:

- The fundamental intention of the Act is that local markets become competitive, not just for selected customers in certain metropolitan areas, but broadly throughout a state. However, the only way that ubiquitous competition can become a reality, is if the existing network is available for other competitors to use to provide local exchange and exchange access services. This is the core objective of this arbitration: to establish the terms, conditions and prices under which BellSouth's network and services will be available to rivals, including AT&T.
- The principal mechanism available to the Commission to influence the prices and choices experienced by consumers in the future is through its role establishing the prices and choices available to *carriers*. The path to consumer protection is choice -- choice among competing providers that are able to offer services with equal quality and comparable prices to those of BellSouth.
- The key to realizing the full benefits of competition is correctly pricing the network elements and resold services that rivals will purchase from BellSouth to provide service to end users. Where the entrant purchases the network functionality or facility underlying a service, the price of these elements should be their forward-looking, long-run incremental cost. Where a carrier purchases a wholesale service, the price of the wholesale service should be calculated by fully removing retail-related costs. Only under these pricing rules will entrants have the ability to broadly approach the market and provide consumers with a choice of local service provider.
- Providing entrants access to the existing network is the fastest path to deployment of competing facilities networks. Resale and the availability of unbundled network elements will both accelerate the construction of alternative local networks and yield a far more competitive environment at the end of the entry process than would otherwise exist.
- Consumers will consider local competition a failure unless consumers easily can change local carriers, and competitors may easily serve them. A robustly competitive local environment requires operational support systems that enable entrants to translate these new carrier-to-carrier arrangements into end user services and easily implement a consumers' decision to change its local service provider without extensive delays or unnecessary costs.

What matters most at the conclusion of this proceeding is that multiple entrants have the opportunity to broadly approach the South Carolina marketplace, designing services which they believe best satisfy the needs of their customers, on an

1 economic basis similar to that of BellSouth, and fully supported by operational  
2 systems which easily accommodate the choice made by consumers.

3  
4 **Q. WILL THE COMMISSION'S DECISION HERE ESTABLISH THE BASIC**  
5 **CONDITIONS FOR ENTRY?**

6 **A.** Yes. In this arbitration, the Commission will *comprehensively* establish *each* of the  
7 tools contemplated by the Act to promote local competition. The full mosaic of  
8 entry tools are needed if AT&T (or any other carrier) is to broadly approach the  
9 market, offering service to both residential and business customers. Because AT&T  
10 is requesting a full range of entry options -- options to which it is entitled under the  
11 Act -- the Commission will be establishing not only conditions necessary for  
12 AT&T's entry, but just as significantly, the conditions of entry for the entire  
13 industry.

14  
15 **Q. ARE THE RECOMMENDATIONS IN YOUR TESTIMONY CONSISTENT**  
16 **WITH THE FCC'S RULES IMPLEMENTING THE ACT?**

17 **A.** Yes. Although those portions of the FCC's Rules addressing pricing have been  
18 stayed, the remainder of its Rules establishing the *minimum* set of network elements  
19 that BellSouth must offer, requiring that network elements be provided in any  
20 combination without restriction, and ordering the introduction of non-discriminatory  
21 operating systems remain in effect. The FCC's Rules move the Act one step closer  
22 to implementation, but it will be this Commission's resolution of the issues in this  
23 arbitration that actually will determine the choices that South Carolina consumers  
24 face, and the prices that they pay.

25

1 Also I would note that the stay of the FCC's pricing rules also stay the FCC's  
2 interim surcharge on purchasers of the unbundled local switching element. The  
3 FCC Rules had provided state commission with the *option* of adopting a similar  
4 interim surcharge plan for intrastate toll calls originated or terminated by new  
5 entrants who purchase unbundled local switching elements. (FCC Order ¶ 729). I  
6 believe such a plan is unnecessary, is likely to lead only to fewer choices for  
7 consumers or higher consumer prices, and, during the pendency of the stay, would  
8 violate other FCC rules which remain in effect. The South Carolina Commission  
9 should explicitly reject any effort by BellSouth to impose an intrastate transitional  
10 surcharge.

11

12 **Q. DO YOU HAVE ANY ADDITIONAL OBSERVATIONS?**

13 A. Yes. I offer two precautionary notes concerning how rapidly the market will change  
14 even after this Commission reaches its decision in this arbitration. The correct  
15 decision here *should* provide the foundation for competition and consumer choice.  
16 But local competition will not be instantaneous. Implementing this Commission's  
17 decision will take some time. It is for this reason (among others) that the  
18 Commission should move expeditiously to implement each of the comprehensive  
19 elements requested by AT&T so that competitive entrants can begin to test which  
20 options are most efficient to serve South Carolina consumers.

21

22 Second, it is useful to recognize that this proceeding concerns only half of the Act's  
23 fundamental equation: opening BellSouth's monopoly in the local exchange market  
24 to competition. The second half of the equation, allowing BellSouth to provide long  
25 distance services in its territory is a question that is relevant only *after* local markets

11

1 become competitive. This single-minded focus on opening the local exchange  
2 market to competition is appropriate because establishing local competition is, by  
3 itself, a substantial and unprecedented undertaking that requires the Commission's  
4 undivided attention. What is important, however, is that the Act itself adopted a  
5 *compromise* -- effective local competition in exchange for interLATA entry -- and  
6 accomplishing the first step requires forcefully and completely implementing the  
7 tools entrants need to offer local services. The Commission cannot compromise its  
8 decision here without diluting the basic framework of the Act, seriously delaying  
9 local competition and the industry changes it is intended to herald.

10

11 **Q. HOW DOES YOUR TESTIMONY RELATE TO THE TESTIMONY OF**  
12 **OTHER AT&T WITNESSES?**

13 **A.** My testimony describes the interrelationship among AT&T's requests in this  
14 arbitration and how these requests fit within an overall strategy to implement the  
15 Act. Other witnesses will provide detailed explanations of AT&T's requests for  
16 network elements, interconnection, transport and termination; wholesale services;  
17 the appropriate economic pricing principles to apply; as well as the particular  
18 dimensions of the operational support systems being requested. My role is to  
19 explain how these carrier-to-carrier issues can be expected to yield tangible benefits  
20 in the prices and choices experienced by consumers.

21

22 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

23 **A.** In the testimony sections which follow, I:

- 24 • describe the competitive environment envisioned by the Act, with  
25 particular emphasis on its effect on consumer prices and choices (Section  
26 II);  
27

12

- 1 • explain the particular importance of local services resale to achieving
- 2 broad customer choice and accelerated entry (Section III);
- 3
- 4 • present the fundamental role of unbundled network elements --
- 5 particularly *combinations* of network elements -- to achieving the
- 6 competitive structure contemplated by the Act (Section IV);
- 7
- 8 • describe the appropriate structure for the transport and termination of
- 9 local traffic (Section V); and
- 10
- 11 • conclude with a discussion of the importance of operational changes
- 12 needed to provide consumers with the widest choices with the least
- 13 disruption (Section VI).
- 14

15 Q. IS THERE ANYTHING ELSE YOU WOULD SUGGEST?

16 A. To help illustrate, summarize and depict certain key aspects of my testimony, I have

17 attached a set of illustrative/demonstrative aides. See Exhibit JPG-2.

18

19 **II. ACHIEVING THE COMPETITIVE ENVIRONMENT**

20 **OF THE TELECOMMUNICATIONS ACT**

21

22 ***A. The Competitive Environment***

23

24 Q. PLEASE DESCRIBE THE COMPETITIVE ENVIRONMENT ENVISIONED

25 BY THE ACT.

26 A. The eventual competitive environment contemplated by the Act is an industry

27 structure unseen since the divestiture of the Bell System in 1984: the emergence of

28 the full service provider, a single firm offering local and long distance services. Of

29 course, this time around, the goal is *multiple* full service providers, and not the

30 reemergence of the Bell monopoly. Contemporary labels such as interexchange

1 carrier (IXC), competitive local exchange carrier (CLEC) and local exchange carrier  
2 (LEC), will become far less important (perhaps disappear) in the eyes of consumers.

3  
4 The threshold condition necessary to achieving this competitive end-point is a  
5 system of arrangements between carriers addressing network elements, reciprocal  
6 compensation, network interconnection and the resale of wholesale services. These  
7 basic tools will foster robust retail competition where consumer benefits arise  
8 relatively quickly, while the slower process of constructing networks moves  
9 forward.

10  
11 Importantly, Congress took the steps necessary to effect the transition to a fully  
12 competitive environment by adopting a completely new framework to govern the  
13 relationship between incumbent LECs and other carriers. This *carrier-to-carrier*  
14 framework provides entrants quite different entitlements -- and imposes on  
15 incumbent LECs quite different obligations -- than have existed in the past. This  
16 carrier-to-carrier framework is designed so that entrants may use BellSouth's  
17 *existing* network to fashion their own local exchange and exchange access services  
18 on an economic basis comparable to BellSouth.

19  
20 **Q. WHAT ARE THE CORE ELEMENTS OF THE CARRIER-TO-CARRIER**  
21 **FRAMEWORK OUTLINED BY THE ACT?**

22 **A.** The core provisions describing these new carrier-to-carrier relationships are  
23 contained in Sections 251 and 252 of the Act. In simple terms, these Sections  
24 impose on incumbent LECs, like BellSouth, the obligation to permit the resale of its  
25 retail services at wholesale prices, to make available elements of its network to

1 entrants at cost-based rates, and to implement a system of reciprocal compensation  
2 for the transport and termination of traffic. It is important to understand that  
3 together these items form the backbone of the relief AT&T seeks and are not options  
4 which BellSouth may, or may not, fulfill at its discretion. Rather, these are clear  
5 obligations which Congress adopted in order to effect a fundamental change in the  
6 telecommunications industry by promoting robust local entry.

7  
8 **Q. WHY WOULD CONGRESS HAVE ADOPTED CARRIER-TO-CARRIER**  
9 **ARRANGEMENTS WHICH PROVIDE ENTRANTS THESE RIGHTS?**

10 **A.** The Act fundamentally recognized that full competition would be seriously delayed,  
11 if not effectively foreclosed, if it first required the building of new competitive  
12 exchange networks -- networks which, in some areas, may never be constructed.  
13 The Act removed this impediment by making the existing LEC network available to  
14 rivals, both to provide consumers choices more quickly and to accelerate the  
15 building of competitive exchange networks. As the FCC noted:

16 Congress addressed these problems [barriers to entry in the  
17 local market] in the 1996 Act by mandating that the most  
18 significant economic impediments to efficient entry into the  
19 monopolized local market must be removed. The  
20 incumbent LECs have economies of density, connectivity,  
21 and scale; traditionally, these have been viewed as creating  
22 a natural monopoly. As we [the FCC] pointed out in our  
23 NPRM, the local competition provisions of the Act require  
24 that these economies be shared with entrants. (FCC Order,  
25 ¶ 11).  
26

27 **Q. WHY DON'T CARRIERS SIMPLY CONSTRUCT THEIR OWN LOCAL**  
28 **NETWORKS?**

29 **A.** While some local networks are under construction, no carrier can construct  
30 ubiquitous local networks capable of supporting broad competition throughout

1 BellSouth's territory. BellSouth's exchange network in South Carolina has  
2 approximately 343,659 business access lines and 910,703 residential access lines.<sup>1</sup>

3 The ubiquity, reach and capacity of this network is enormous.  
4

5 **Q. IS LOOP CAPACITY THE MOST SIGNIFICANT MEASURE OF THE**  
6 **DOMINANCE OF BELL SOUTH'S EXCHANGE NETWORK?**

7 **A.** No. Measuring the network solely in terms of loops (i.e., the last connection to the  
8 customer) significantly understates the enormous (in fact, unprecedented)  
9 investment that would be necessary for even a single provider -- much less the  
10 multiple providers necessary for a fully competitive environment -- to duplicate. In  
11 addition to the loop plant to each and every premises in its territory, BellSouth's  
12 exchange network encompasses more than 200 local switches (including remotes)  
13 interconnected by a vast web of interoffice facilities. (Source: 1995 ARMIS 43-  
14 07). Because of the size and geographic reach of BellSouth's network, local  
15 competition would develop at a snail's pace unless this network could be used by  
16 other carriers to provide local exchange and exchange access services.  
17

18 **Q. IS THE ACT INTENDED PRIMARILY TO EASE ENTRY BARRIERS TO**  
19 **PROVIDE CARRIERS WITH NEW BUSINESS OPPORTUNITIES?**

20 **A.** No. In my opinion, the Act's ultimate purpose is to provide consumers with local  
21 choices (as they now enjoy in long distance); to eliminate confusion caused by the  
22 divestiture of the Bell System (separate providers of intraLATA and interLATA  
23 services), while retaining all of the divestiture's competitive benefits; and to set the

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<sup>1</sup> Source: 1995 ARMIS 43.08, Table III, Access Lines in service by customer.

1 stage for less regulation of consumer prices. However, the path to lower consumer  
2 prices, newer services and increased convenience is through the tools contemplated  
3 by these new carrier-to-carrier arrangements required by the Act.

4

5 ***B. The Importance Of Quickly Reducing Local Entry Barriers***

6

7 **Q. WHY IS IT IMPORTANT TO REDUCE LOCAL ENTRY BARRIERS**  
8 **QUICKLY?**

9 **A.** As noted earlier, the fundamental balance of the Act is to establish the tools needed  
10 for other carriers to offer local services and, once effective local competition is  
11 firmly established, to permit BellSouth to offer long distance services in its territory.

12

13 However, unlike the very real obstacles to local competition faced by rivals, the  
14 barriers confronting BellSouth essentially can be eliminated "with the stroke of a  
15 pen." Once legal restrictions are removed, BellSouth will be able to offer long  
16 distance services quickly and completely because entry barriers to the long distance  
17 market have fallen already in response to competitive entry.

18

19 Barriers to entry in the long distance market are low because there is competition at  
20 both the marketing (retail) and network (wholesale) levels. At the wholesale level, a  
21 variety of companies compete to provide the central ingredients of long distance  
22 services — transmission, switching, and billing. In effect, the long distance  
23 equivalents to unbundled network elements and the resale of wholesale services are  
24 already in place. A new entrant to the long distance market need not construct its  
25 own network or wait for the development of back-office systems to offer its

1 services. The long distance industry already has developed the necessary  
2 infrastructure to support a multi-vendor, competitive environment.

3  
4 **Q. WILL BELL SOUTH BENEFIT FROM THIS MULTI-VENDOR**  
5 **INFRASTRUCTURE WHEN IT IS PERMITTED TO PROVIDE**  
6 **INTERLATA SERVICES IN ITS TERRITORY?**

7 **A.** Yes. BellSouth is in a position to capitalize on the fruits of the long distance  
8 industry's history with competition. Once legal authority is granted, BellSouth  
9 could begin offering long distance services without investing in a single switch or  
10 strand of optical fiber, without obtaining a single right of way, or negotiating a  
11 single interconnection agreement with a recalcitrant monopolist. BellSouth simply  
12 would need to choose an underlying interexchange network supplier (indeed, it has  
13 already chosen AT&T for just this purpose) and begin marketing long distance  
14 services to its preexisting base of local customers, a base which today is the *entire*  
15 market in its exchanges.

16  
17 BellSouth's path to becoming a long distance carrier is well-established, tested and  
18 routine. It is a feat accomplished by thousands of firms since divestiture. Assisting  
19 BellSouth in its task of adding long distance service is a competitive long distance  
20 market with four national networks (plus a number of regional networks). Local  
21 exchange company operational systems (i.e., presubscription processes) are already  
22 sized to process large numbers of consumer requests to change long distance  
23 carriers. Moreover, consumers are accustomed to changing long distance providers.

24

1 Q. WILL BELLSOUTH BENEFIT FROM COMPETITIVELY ESTABLISHED  
2 WHOLESALE PRICING IN THE INTEREXCHANGE MARKET?

3 A. Yes. According to published reports, BellSouth negotiated a discount of  
4 approximately 85% from prevailing long distance retail rates (net of access).<sup>2</sup> This  
5 discount is the result of a competitive wholesale market that actively solicits retail  
6 carriers with attractive wholesale pricing and operational systems specifically  
7 designed for resale. This discount is also in-line with the discount that NYNEX had  
8 previously indicated to Wall Street analysts that it anticipated on its interLATA  
9 traffic.<sup>3</sup>

10

11 Q. IS THERE AN EXAMPLE WHICH DEMONSTRATES HOW SIMPLE IT  
12 WILL BE FOR BELLSOUTH TO PROVIDE LONG DISTANCE SERVICES  
13 TO CUSTOMERS IN ITS REGION ONCE IT IS AUTHORIZED TO DO SO?

14 A. Yes. GTE provides a useful example of how quickly an incumbent local exchange  
15 carrier can offer long distance services and provides a telling contrast to the  
16 difficulty that AT&T and other local entrants must overcome. It took GTE *less*  
17 *than one hour* from the Act's signing to contract with an underlying carrier for the  
18 services and facilities needed to provide long distance services. The ease of entry  
19 experienced by GTE did not go unnoticed by Wall Street. As Merrill Lynch  
20 reported:<sup>4</sup>

---

<sup>2</sup> BellSouth/AT&T Contract Reinforces the RBOC/GTE Investment Case, Merrill Lynch, June 20, 1996.

<sup>3</sup> Source: Dean Witter, November 6, 1995.

<sup>4</sup> Telecom Services, Merrill Lynch, May 14, 1996, page 6. Emphasis in original.

1 GTE has already begun to offer long distance services to its  
2 in-region customers and intends to gain 10% of its \$4.8  
3 billion addressable long distance market within 12 months  
4 with negligible cost to the bottom line. GTE management  
5 presentations at its quarterly analyst meeting reiterated the  
6 company's plans to achieve 10% EPS growth for the  
7 foreseeable future, despite the "negligible" startup cost of  
8 long distance entry. We also learned the company believes  
9 its long distance effort will generate positive earnings  
10 impact in 1997, which reflects, in our view, the remarkably  
11 attractive economics facing an RBOC entering an adjacent  
12 market (long distance). How often is it that an industry  
13 wakes up one day, finds its addressable market  
14 expanded by 40% and can launch the new service  
15 without noticeable dilution and achieve positive earnings  
16 by the second year?  
17

18 This analysis embodies every conclusion of the market dynamic I have described  
19 above. GTE expects to gain -- and in fact, is gaining -- share rapidly. GTE expects  
20 to do so with negligible costs. GTE's opportunity is *immediate* higher profits and  
21 market share. In fact, GTE's management expects its profitability to grow for the  
22 "foreseeable future."  
23

24 BellSouth's opportunity is no different. Merrill Lynch has termed long distance  
25 service for an RBOC such as BellSouth as the "ultimate" vertical service, noting:<sup>3</sup>

26 We [Merrill Lynch] use the term *ultimate* because, like  
27 other vertical features, long distance can be offered to  
28 already existing customers with *minimal capital investment*,  
29 *but unlike vertical features, customers do not have to be*  
30 *convinced to use it. They already are using it; they just*  
31 *need to be convinced to change suppliers -- something they*  
32 *do every day . . . .*  
33

---

<sup>3</sup> Telecom Services - RBOCs and GTE, Merrill Lynch, August 9, 1996, page 4, emphasis in original.

1 Q. WHAT WOULD BE THE EFFECT OF BELL SOUTH'S ENTRY INTO THE  
2 LONG DISTANCE MARKET WITHOUT FIRST ESTABLISHING WIDE-  
3 SCALE LOCAL COMPETITION?

4 A. If a large portion of the market prefers to obtain its telecommunications services as a  
5 package -- and this perspective appears borne out by GTE's experience -- then the  
6 absence of competition for *any* element of the package (i.e., local exchange service)  
7 would distort competition for *all* services that are, (or, more precisely, will be) sold  
8 as a package. Because local exchange service will likely be seen as a compulsory  
9 element of the package in the eyes of many (if not most) consumers, local service  
10 *must* become competitive or competition for other services, such as long distance,  
11 will suffer.

12

13 The re-creation of the Bell System monopoly is not what Congress intended or  
14 consumers deserve. The Bell System divestiture was successful. Barriers to long  
15 distance entry were greatly reduced, AT&T lost its monopoly, fiber and digital  
16 technology were rapidly deployed, prices fell, and consumers enjoyed choice in  
17 virtually every market. The Act essentially extends the pro-competitive policies of  
18 the Bell System divestiture to all services. Just as divestiture provided AT&T's  
19 competitors with access to the local network on equal terms in order to originate and  
20 terminate long distance calls, the Act makes the local exchange network available to  
21 competitors on equal terms for *every* purpose, including the provision of local  
22 exchange and exchange access.

23

**C. The Tools Of Comprehensive Entry:**

**Resale And Network Elements**

**Q. HOW WILL COMPETITION PROCEED DESPITE THE DOMINANCE OF BELL SOUTH'S NETWORK?**

**A.** Congress recognized the massive dominance of the incumbent LEC's network and the reality that it will take many years for the local transmission (especially loop) market to become as competitive as the interexchange transmission market. Alternative networks will take time to develop. As a result, the Act provides for a number of entry strategies that rely, to one extent or another, on the immediate use of BellSouth facilities and services by other providers.

Each of these strategies can be found in the central components of AT&T's requests that led to this arbitration. These key components include AT&T's request to:

- resell wholesale equivalents of BellSouth's retail services,
- provide local exchange and exchange access services using network elements -- including complete combinations of network elements -- obtained from BellSouth as basic ingredients to AT&T's services, and
- the transport and termination of traffic under reciprocal compensation arrangements.

In later sections of my testimony, I address more extensively the importance of network elements (Section IV) and reciprocal compensation (Section V) to providing exchange services. The point that I would like to emphasize here is the significance of *comprehensively* establishing the basic conditions of local competition. Comprehensively opening the local market by establishing the full

1 range of entry options is important because not every entry strategy is appropriate  
2 for every customer or market.

3  
4 There are at least three features of a comprehensive arbitration request that set it  
5 apart: (1) the intended *scale* of entry; (2) *applicability* to other entrants; and, (3) the  
6 need for systems to support customer choice with a *convenience* already accepted in  
7 the market.

8

9 **Q. WHAT DO YOU MEAN BY "SCALE OF ENTRY"?**

10 A. By scale of entry I mean AT&T's ability to broadly address its existing base of  
11 subscribers. No single entry vehicle is best suited for every customer and  
12 geographic consideration. Some strategies -- loop resale for instance -- are  
13 particularly ill-suited for mass application because they either require physical  
14 circuit rearrangements as customers move between providers or presuppose the  
15 extensive deployment of alternative networks which do not now exist. Broad entry  
16 requires that the full range of entry strategies be available so that a carrier may tailor  
17 its offerings to particular conditions.

18

19 **Q. WITH RESPECT TO YOUR SECOND POINT, HOW IS AT&T'S**  
20 **PROPOSED INTERCONNECTION AGREEMENT APPLICABLE TO**  
21 **OTHER ENTRANTS?**

22 A. Because AT&T's request is so comprehensive, its value extends beyond this single  
23 entrant to an entire industry. By encompassing all possible entry strategies, AT&T's  
24 request necessarily includes the individual approaches that other carriers will use to  
25 address their markets. This observation is particularly important. By deciding this

23

1 arbitration, the Commission is establishing the conditions of entry not just for  
2 AT&T, but effectively defining the minimum entry conditions for any entrant that  
3 will use all (or part) of BellSouth's network to provide local services.

4  
5 **Q. PLEASE EXPLAIN WHY AT&T'S COMPREHENSIVE REQUEST**  
6 **EMPHASIZES OPERATIONAL DETAIL.**

7 A. Just as the development of meaningful long distance competition required new  
8 systems to support a multi-vendor environment, meaningful local competition will  
9 not succeed without a similar commitment of industry resources to operational  
10 support. This is an important issue because consumers will widely perceive local  
11 competition -- and the Congressional action upon which it relies -- as a failure if  
12 changing local telephone providers is associated with extended delays, high costs,  
13 periods of outage, unreliable bills, or disrupted services. Operational systems are  
14 absolutely critical to robust competition in the local exchange market.

15  
16 The process with which consumers are familiar -- and which BellSouth some day  
17 will use to enter the long distance market -- allows consumers to change long  
18 distance carriers (i.e., their primary interexchange carrier, or PIC) with a simple  
19 telephone call or stroke of the pen. It is an easy, streamlined process. The operating  
20 standards of this process, in terms of cost, speed and accuracy, should become the  
21 standard for judging systems used to change local service providers as well.

22  
23 **Q. DO THE FCC'S RULES REFLECT THIS PERSPECTIVE THAT A**  
24 **CONSUMER'S DECISION TO CHANGE LOCAL PROVIDERS SHOULD**  
25 **BE AS SIMPLE AS THE PIC-CHANGE PROCESS?**

1 A. Yes. Rule §51.319(c)(1)(ii) includes the requirement that wherever the change in  
2 the customer's local service provider is accomplished through a software event (i.e.,  
3 resale arrangements or configurations using unbundled local switching), the change  
4 in a customers' local service provider must occur in an interval no longer than the  
5 interval in which an incumbent LEC transfers end-users between interexchange  
6 carriers.

7

8 ***D. Entry And Facilities Deployment***

9

10 **Q. WILL THE RESALE OF WHOLESALE SERVICES AND ACCESS TO**  
11 **NETWORK ELEMENTS SPUR NETWORK CONSTRUCTION?**

12 A. Yes. These tools are essential for local competition to proceed and to provide the  
13 appropriate foundation for the network construction that will continue for the  
14 indefinite future. The Department of Justice recently reached the identical  
15 conclusion, noting in its comments to the FCC (Docket 96-98, page 37) that:

16 Reducing entry barriers into local markets by permitting  
17 resale [of wholesale services] and cost-based access [to  
18 network elements] is much more likely to lead to the greater  
19 development of facilities-based competition than would  
20 occur absent such access and resale opportunities.  
21

22 Entry using BellSouth's network will permit entrants to build the necessary revenue  
23 streams to justify the massive investment necessary to construct even relatively  
24 modest local networks. As entrants build their base of customers using wholesale  
25 services and unbundled network elements, they then will be able to make rational

1 investment decisions concerning where to construct networks, invest in switching,  
2 add new capabilities, etc.<sup>6</sup>

3  
4 **Q. DOES THIS PROCESS PARALLEL THE DEVELOPMENT OF FACILITIES**  
5 **COMPETITION IN THE LONG DISTANCE MARKET?**

6 **A.** Yes. In the long distance market, early entrants like MCI were able to expand their  
7 services and customer base by reselling services off of AT&T's network. This  
8 growth financially justified the deployment of their own networks, providing  
9 internal investment capital and shareholder confidence. and encouraged the entry of  
10 others, including (what is now) the third major network provider, Sprint. Later, the  
11 continued growth of the resale market resulted in the construction of the fourth  
12 national network (Wiltel) for the express purpose of providing wholesale carrier-to-  
13 carrier services for use by the "resale" industry.

14  
15 **Q. WILL NETWORK CONSTRUCTION BE INSTANTANEOUS?**

16 **A.** No. Local facilities deployment is a long-term proposition. It took the Bell  
17 operating companies more than 100 years to achieve the present state of the network  
18 and the Commission should not expect entrants to deploy comparable networks  
19 overnight.<sup>7</sup>

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<sup>6</sup> Teleport, in fact, has publicly stated that its business strategy is to win customers first and then build facilities in an efficient way to serve them (Telecommunications Reports, October 16, 1995, page 20).

<sup>7</sup> The Commission also should recognize that the Act provides a strong, potentially threatening, incentive for local network investment, that is, BellSouth's becoming a long distance company. This single action will transform BellSouth from the long distance industry's principal *supplier* to its principal *rival*. Long distance companies will not want to be as dependent upon BellSouth as they are today once BellSouth becomes their main competitor. Each will construct, and encourage the construction by others, of other networks in as short a time as possible.

1

2 **Q. DO YOU EXPECT CARRIERS WILL REPLICATE THE ENTIRE**  
3 **BELLSOUTH NETWORK?**

4 A. No. It is likely that some portions of the network may never see a competitive  
5 alternative, certainly in the next several years. For instance, it is easy to visualize  
6 significant resistance on the part of residential homeowners to multiple network  
7 interface boxes being installed on their premises to reflect previous, and future,  
8 competitive choices in local services. Other elements of the network may best be  
9 provisioned by a sole network vendor (for instance, the loop and local switching in  
10 many areas). The point is not simply to encourage new construction -- the goal is to  
11 encourage *efficient* facilities deployment. Wholesale services and economically  
12 priced unbundled network elements are key elements of this transition.

13

14

### **III. LOCAL SERVICES RESALE**

15

16 **Q. WHAT IS LOCAL SERVICES RESALE?**

17 A. Local services resale is the purchase of an incumbent LECs services by a competing  
18 local service carrier on a wholesale basis with the intent to resell these services to  
19 consumers. Wholesale local services are expressly designed, supported, and *priced*  
20 to be resold by another carrier in the retail market. These wholesale local services  
21 provide multiple entrants a simple means to begin offering local exchange services  
22 and attract customers. BellSouth is required to offer its local services for resale at  
23 wholesale rates under Section 251(c)(4) of the Act.

24

1   **Q.    WILL LOCAL SERVICES RESALE PROVIDE IMMEDIATE CONSUMER**  
2   **BENEFITS?**

3   **A.    Yes. In the long distance marketplace today, many carriers buy long distance**  
4   **services at wholesale rates for purposes of reselling them to customers, and compete**  
5   **by differentiating their billing systems, customer support and other elements of**  
6   **services. This same strategy can be extended to the local marketplace, with carriers**  
7   **using their marketing and customer skills to resell services obtained from the**  
8   **incumbent LEC.**

9  
10   **Q.    WILL LOCAL SERVICES RESALE PROVIDE AN EFFECTIVE CHECK**  
11   **ON BELL SOUTH'S PRICING?**

12   **A.    Only in small ways. Requiring BellSouth to provide wholesale local exchange**  
13   **services will limit its ability to discriminate between classes of customers, except**  
14   **where the Commission has blessed such discrimination to satisfy a unique public**  
15   **need (such as, for instance, preventing LifeLine services from being offered outside**  
16   **the targeted class).**

17  
18   **Wholesale services, however, will not police the overall level of rates as effectively**  
19   **as the pricing of unbundled network elements and interconnection as discussed**  
20   **earlier in this testimony. This is because the wholesale price is calculated off the**  
21   **retail rate. As retail prices move up, so too do wholesale rate levels, and price**  
22   **competition is constrained by the differential. As a result, only limited price**  
23   **competition is made possible by reselling wholesale services. Thus, the need to**  
24   **regulate BellSouth's retail rates remains unchanged.**

25

1 Q. SHOULD ALL RETAIL SERVICES HAVE A WHOLESALE  
2 EQUIVALENT?

3 A. Yes. There are a number of strategies that BellSouth could use to limit the  
4 usefulness of the wholesale option. Several of the agreements which have been  
5 reached recently -- importantly, with carriers that have little or no interest in  
6 reselling BellSouth's services -- expose this strategy. In particular, BellSouth  
7 proposed to AT&T several exclusions to its wholesale pricing and resale  
8 obligations.

9  
10 These exclusions could be used by BellSouth to effectively evade its wholesale  
11 obligation by selectively targeting customers for special pricing, rolling promotions,  
12 and grandfathering, which is a more polite phrase for warehousing, large sections of  
13 the market. Together, these exclusions could eliminate the wholesale option as an  
14 entry option.

15  
16 Q. WHAT IS THE BASIC APPROACH TO CALCULATING THE  
17 WHOLESALE PRICE FOR LOCAL SERVICES?

18 A. The basic approach is to remove from the retail price an estimate of the retail-related  
19 costs that will be avoided by BellSouth as a wholesaler of services. This perspective  
20 also underlies the FCC's rules relating to wholesale pricing.

21  
22 Q. WHAT WOULD OCCUR IF THE COMMISSION DOES NOT FULLY  
23 REMOVE THESE RETAILING COSTS WHEN ESTABLISHING THE  
24 WHOLESALE RATE?